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BEFORE THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA

Order Instituting Rulemaking to Promote Policy And Program Coordination and Integration in Electric Utility Resource Planning.	Rulemaking 04-04-003 (Filed April 1, 2004)
Order Instituting Rulemaking to Promote Consistency in Methodology and Input Assumptions in Commission Applications of Short-run and Long-run Avoided Costs, Including Pricing for Qualifying Facilities.	Rulemaking 04-04-025 (Filed April 22, 2004)

RESPONSE OF THE COGENERATION ASSOCIATION OF CALIFORNIA AND THE ENERGY PRODUCERS AND USERS COALITION TO THE JOINT PARTIES' APPLICATION FOR REHEARING OF DECISION 07-09-040

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November 9, 2007

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The Cogeneration Association of California (CAC)[1] and the Energy Producers and Users Coalition (EPUC)[2] (jointly, CAC/EPUC) submit this Response to the Joint Parties' Application (Application) for Rehearing of Decision

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1 CAC represents the power generation, power marketing and cogeneration operation interests of the following entities: Coalinga Cogeneration Company, Mid-Set Cogeneration Company, Kern River Cogeneration Company, Sycamore Cogeneration Company, Sargent Canyon Cogeneration Company, Salinas River Cogeneration Company, Midway Sunset Cogeneration Company and Watson Cogeneration Company.

2 EPUC is an ad hoc group representing the electric end use and customer generation interests of the following companies: Aera Energy LLC, BP America Inc. (including Atlantic Richfield Company), Chevron U.S.A. Inc., ConocoPhillips Company, ExxonMobil Power and Gas Services Inc., Shell Oil Products US, THUMS Long Beach Company, Occidental Elk Hills, Inc., and Valero Refining Company - California.

07-09-040 (Decision).[3] The Response is submitted pursuant to Article 16 of the Rules of Practice and Procedure of the California Public Utilities Commission (Commission) and Section 1731 of the Public Utilities Code.

I. INTRODUCTION

Both existing QFs with expiring contracts and new QFs hoping to secure operational certainty have been waiting for a long-term Commission QF policy since as early as 2002. The Commission made express directives to sustain existing QFs on-line, and provided interim relief to QFs with expired or expiring contracts. This relief period ("bridge" period) originally focused on contracts expiring during the "brief" period in which the Commission was working to establish its final QF policy and contract options. In 2002 the Commission perceived that development of its QF policy was imminent. The Commission provided interim relief, in the form of an SO1 Contract, in a series of decisions. First, an SO1 was ordered for QFs with contracts set to expire before <u>January 1, 2004</u>, or already expired. (D.02-08-071 at 32) In D.03-12-062, the Commission extended the interim relief from D.02-08-071 to contracts set to expire before <u>January 1, 2005</u>. In D.04-01-050, the Commission continued the interim SO1 contract treatment for QF contracts expiring before <u>January 1, 2006</u>. In D.05-12-009, the Commission extended the interim relief provided to expiring QF contracts "*from January 1, 2006 until the Commission issues a final decision in*

[3] The Joint Parties include Pacific Gas & Electric Company (PG&E), Southern California Edison Company (SCE), San Diego Gas & Electric Company (SDG&E), The Utility Reform Network (TURN), and the Division of Ratepayer Advocates (DRA). The Joint Parties' Application was filed on October 25, 2007.

*the combined two dockets, Rulemaking (R.) 04-04-003 and R.04-04-025." (*D.05-12-009 at 1*)*

The single form of interim relief, the SO1 contract option, is for as-available QF resources, *i.e.*, this contract is misapplied to firm capacity generation suppliers. However, no other viable contract options were available (as evidenced by the interim relief). QFs, like the Commission, believed that development of a long-term policy, and a firm capacity contract option, was in fact imminent. Consequently QF firm capacity resources were effectively compelled to accept the interim relief as-available capacity contracts. This resulted in firm resources, which have reliably delivered power to the utilities for decades, providing firm power under terms and prices for as-available suppliers.

It has taken until September 20, 2007 to finally issue Decision 07-09-040. There are still workshops to address implementation issues and continuing critical matters from that decision, including the development of a final standard offer contract for both as-available and firm capacity resources. The Decision balances complex and competing interests to arrive at a reasonable compromise consistent with both state and federal law and policy. The Decision provides the possibility of material options for both existing and new QFs. However, there is still much work to be done to implement the Commission's directives. This remaining work will likely be as contentious and difficult as the over four years of proceedings leading up to the workshops on implementation.

The Commission must not allow this process to be delayed any further. The Commission's efforts to achieve a balanced decision consistent with law seem to be lost on the Joint Parties. These parties reargue stridently held litigation positions that have been heard, adjudicated and rejected. Time is long past for moving on to accept the Commission's direction and to allow the implementation of the order. Other than one single issue[4], there is no basis to sustain the Joint Parties' Application. The Joint Parties' Application should be denied. The Commission should reaffirm directives requiring an urgent and timely implementation of the Commission's Prospective QF Policy.

Specifically the Commission should:

1. Continue to use, under the MIF, the SCE TOU formula for determining the monthly time differentiated SRAC energy pricing for QF power sold to SCE;

2. Reject the Joint Parties' request for rehearing regarding the Commission's adoption of the MIF, with its use of the administrative heat rate;

3. Reject the Joint Parties' request for rehearing regarding the Decision making standard offer contract options available to new "small" QFs;

4. Reject the Joint Parties' request for rehearing regarding the Decision failing to order a retroactive true-up of SRAC energy payments; and

5. Reject the Joint Parties' request for rehearing regarding the Decision requiring the incorporation of the new pricing adopted in the Decision into existing standard offer contracts on an interim basis.

[4] The continued use, under the MIF, of the SCE TOU formula for determining the monthly time differentiated SRAC energy pricing for QF power sold to SCE.

II. DISCUSSION

A. CAC/EPUC Do Not Oppose Use Of SCE's Existing TOU Formula Under The MIF For Time Differentiated SRAC Energy Pricing.

The Joint Parties argue that applying the adopted Market Price Referent (MPR) time of use (TOU) factors to the Short Run Avoided Cost (SRAC) energy pricing resulting from the Market Index Formula (MIF) constitutes error. (Application at 4-6) CAC/EPUC do not agree that the Commission's determination is legal error; however CAC/EPUC conditionally support SCE's retention of existing TOU formula.

It is appropriate to retain the existing SCE TOU formula to establish SCE's current "SRAC Energy Price Update for Qualifying Facilities" ("the SRAC Posting"). The TOU formula reasonably determines the MIF time differentiated SRAC energy payments for SCE. The monthly TOU formula reflected in the Posting is predicated on existing TOU factors. The TOU factors should continue until revisions are addressed in an appropriate proceeding. As noted by the Joint Parties, no party submitted testimony requesting a change to SCE's TOU factors in this proceeding. (Application at 5, footnote 10)

CAC/EPUC's support on this issue is unique to the particular circumstances presented, and should not be considered precedential for any purpose, including other utilities' TOU determinations. Moreover this support for SCE's TOU formula does not affect CAC/EPUC's reservation of rights to challenge any future TOU factors or time of delivery allocations proposed by SCE or any other party.

B. The Evidence In This Proceeding Demonstrates That The Administrative Heat Rate Produces Energy Prices That Are Consistent With The Utilities' Short Run Avoided Cost (SRAC) Of Energy Derived from Publicly Available Data.

The Joint Parties allege that the administrative heat rate is outdated and results in an MIF which produces energy prices that exceed the utilities' purported SRAC at the time of delivery.[5] The Joint Parties' allegation is erroneous on several grounds. First, no QF party in this proceeding knows or has access to information to show what the utilities' actual avoided costs are. There is no record evidence in this proceeding providing required data to demonstrate the utilities' cost, load and resource data. Second, the record evidence that does exist from public information demonstrates that the administrative heat rate is reflecting costs that are the utilities' apparent avoided cost under PURPA.

Record evidence demonstrates that the so called "Market Heat Rate" (MHR) proposals of PG&E and SCE for SRAC energy pricing result in prices significantly below the utilities' short run avoided energy costs based upon publicly available data in the record. It is the utility proposed MHR prices that lack record support, not the administrative heat rate. There is substantial evidence to sustain the Commission's reliance on and adoption of the "Administrative Heat Rates" of 9,794 Btu/kWh and 9,705 Btu/kWh for PG&E and SCE, respectively. The utility challenges lack merit, are factually incorrect and

[5] CAC/EPUC has repeatedly demonstrated in this proceeding that any reliance on the current record, which did not allow QF Parties' access to relevant data, is unlawful. Federal law requires that QFs be paid based upon the utilities' avoided cost and lists the utility data required to calculate avoided costs. 18 C.F.R. 292.302. Lack of access to information rendered the QFs unable to determine the actual utility avoided cost and present that position to the Commission.

should be rejected. Several reasons exist to sustain these heat rates, and the Commission's adoption does not constitute legal error.

1. The Publicly Available Record Evidence Demonstrates That IOU MHR Proposals Result in SRAC Energy Prices That are Below PG&E and SCE Avoided Energy Costs.

a. IOU proposals: NP15 and SP15 DA prices.

PG&E and SCE assert that their ability to "dispatch" against day-ahead prices provides a basis for those prices to be considered as a proxy for their avoided costs. *See,* Exh. 01-SCE (Jurewitz, Direct Testimony), at 41-45; *see also,* Exh. 28-PG&E (Coffee, Direct Testimony), at 3-8. The day-ahead market volumes actually purchased by the IOUs and relied upon to serve bundled customer load, however, are miniscule. For example, the **actual volume** of power purchased by SCE from the SP15 day-ahead market is **less than 5%** of SCE's bundled deliveries to its customers. *See* 20 Tr. 2901 (Jurewitz, SCE) Jan. 19, 2006 (*"it's less than 5 percent"*). The amount of QF power serving bundled customer load is more than triple the volume of SCE's day-ahead market purchases. These facts support the Commission's rejection of the IOUs' proposals to base QF pricing for SRAC energy solely on such a small sliver of the IOUs' actual resource base. The Commission did not err.

Moreover, Dr. Fox-Penner, the expert witness for PG&E and SCE, did not even examine the IOU's actual costs in his determination that the NP15 and SP15 DA markets would track those costs over time, as a proxy should. *See* Exh. 134-CAC/EPUC (Ross/Schoenbeck, Redlined Errata to Direct Testimony)(data responses from Dr. Fox-Penner indicating that he had not executed the protective order and did not have access to relevant IOU data).

Furthermore, IOU witness Dr. Berry's analysis was demonstrated to be fundamentally flawed. Her "adjustment" to the 390(b) formula mistakenly assumes that the transition formula is supposed to track NP15 day-ahead prices when it is actually supposed to track IOU avoided costs; her reliance on Dr. Fox-Penner further undermines her analysis. *See* 135-CAC/EPUC (Ross/Schoenbeck, Redlined Errata to Reply Testimony), at 24-25. Moreover, Dr. Berry should have used all the data available to test her model, rather than selectively picking and choosing. *See* 26 Tr. 3877-3878 (Monsen, IEP) Jan. 27, 2006.

Additionally, the IOUs undeniably have monopsony power in the day-ahead markets for their monopoly service territories, which distorts these markets. For example, PG&E's witness Mr. Coffee estimated that PG&E was responsible for **roughly half** of the NP15 daily activity.

> *Q So would you say that on average, the day-ahead market trades about 36,000 megawatt hours at least in this period we're talking about, January of 2002 to July 2005?*
>
> *A That time period from January 2002 through May 2005, that's correct.*
>
> *Q How much of that 36,000 megawatt hours per day reflects PG&E transactions, generally speaking?*
>
> *A It varies. …*
>
> *Q Do you have -- if you could give me an average because we're taking daily averages. Do you have a sense of what a daily average would be?*
>
> *A As I look at things, I look in terms of megawatts; okay. So I convert the 13,000 megawatt hours for the on-peak period to roughly about 8 to 900 megawatts divided by 16 hours on a daily basis. So that's roughly 16-, 1700 megawatts and then the last during -- the volume increasing during February 2005 to May 2005, you can see the volume increasing to the*

> *point in May of 2005 you have well over 20,000 or 21,000 megawatt hours which is a good 13-, 1400 megawatts at that point.*
>
> *So the average itself over that whole time period about 8- to 900 megawatts and then over the last few months in this table is roughly 14-, 1500 megawatts.*
>
> *So it would be double that. You can get 3,000 at that point for the last period, the last few months.*
>
> *Q Did you answer how much of that is about PG&E -- how much that affects PG&E trading?*
>
> *A Roughly, I mean, once again, it's going to vary. But typically PG&E is a market -- transaction in the market, I'd say anywhere from 500 megawatts to over approaching 2,000 megawatts, depending on what's happening.*
>
> *Q So this is math that I can't do. Can you translate what 500 to 2,000 megawatts would be on a percentage basis of the 36,000 or I guess the 13,000 we're talking about.*
>
> *A* ***<u>So if you say 500 megawatts and then we're saying that on average it's close to 900, it's roughly a little over half.</u>***

24 Tr. 3598-3599 (Coffee, PG&E) Jan. 25, 2006 (emphasis added).

The record evidence does not support any confidence in the short-term forward markets upon which the Market Heat Rate calculation relies. When asked by SCE's attorney whether the ISO's Department of Market Analysis (DMA) had found the short-term forward markets to be "*efficient and well functioning*," the clear answer was, "***No***." 22 Tr. 3236 (Cavicchi/Reishus, Joint QF Parties) Jan. 23, 2006 (explaining that the focus of the DMA inquiry was "*the potential exercise of seller market power*").

These multiple facts of record evidence demonstrate the Commission's sound bases to reject the Utilities' plan to base the SRAC Energy Price solely on their proposed "Market Heat Rate". The record evidence, along with the utter lack of support from IOU actual cost data for the Utilities' SRAC energy proposal, compelled Commission rejection of the Market Heat Rate. The Commission balanced pricing by using a component of an Administrative Heat Rate for pricing SRAC energy. The Commission did not err in its choice.

b. CAC/EPUC Presented Computer Simulation Results That Support the Commission's Adoption of Administrative Heat Rates for SCE and PG&E.

CAC/EPUC performed Aurora Production Simulation modeling that validates the Commission's adoption of Administrative Heat Rates of 9,794 Btu/kWh and 9,705 Btu/kWh for PG&E and SCE, respectively. Even SCE acknowledged that the use of computer production cost simulation modeling was an accepted method for SRAC energy determinations. *"[F]or years and years, we based the energy payment on a production simulation model that took as the price in a particular hour the most expensive unit on the system."* 20 Tr. 2894 (Jurewitz, SCE) Jan. 19, 2006; *see also* 24 Tr. 3578-3579 (Pappas, PG&E) Jan. 25, 2006 (noting the Commission's use "for years" of QF in/out methodology in ECAC proceedings: "***all*** *the QFs that were paid, yeah, SRAC, were removed from the QF out run.*") (Emphasis added). As noted by Mr. Pappas, in the ECAC proceedings, the Commission-approved QF-out run removed **all** of the SRAC QFs.

Notably, criticism of Aurora modeling was unpersuasive and mistaken. Importantly, SCE admitted that it had not verified any of its criticism by running the Aurora model.

> *Q [S]ince you did not actually run the model, you don't know with certainty what the impact of the dispatch markup would be on the incremental energy rate, do you? …*
>
> *A No. I have not run the model.*

19 Tr. 2712-2713 (Silsbee, SCE) Jan. 18, 2006.

Other SCE criticisms of the Aurora model are similarly unfounded and have proven to be so. *See* 19 Tr. 2713 (Silsbee, SCE) January 18, 2006 (admitting that SCE did not actually run the Aurora model and therefore could not be certain of the validity of its criticisms). CAC/EPUC witness Mr. Schoenbeck, however, **did** perform sensitivity runs to assess SCE's criticisms.

> *Upon looking at Edison's rebuttal testimony, we did several runs because we thought every one of their assertions with respect to the Aurora model was dead wrong.* ***So we tested each and every one, and they were all dead wrong.***

29 Tr. 4239-4240 (Schoenbeck, CAC/EPUC) Feb. 1, 2006 (emphasis added).

The Aurora modeling strongly supports the adoption of an Administrative Heat Rate for purposes of SRAC energy pricing in the range of 9,700 to 9,900 Btu/kWh. As noted in the record, the current forward market prices demonstrate that a prospective Incremental Energy Rate or IER (i.e., Administrative Heat Rate) of 9,705 Btu/kWh is appropriate for SCE and an IER of 9,872 Btu/kWh is appropriate for PG&E. *See* Exh. 134-CAC/EPUC (Ross/Schoenbeck, Redline Errata to Direct Testimony), at 68. Commission adoption of the MIF, with its use of the administrative heat rate, is supported by the record and not in error. Similarly, the adoption of a new, small QF option does not constitute legal error.

C. The Decision's New, Small QF Option Is Consistent With Both PURPA And State Law And Policy Encouraging The Development Of Cogeneration Resources.

1. The New, Small QF Option Is Consistent With Federal Law Including The Ketchikan Order.

The Joint Parties allege that the Decision errs by making standard offer contract options available to new "small QFs."[6] The Joint Parties further allege that the Commission "*cannot lawfully require the utilities to enter into standard contracts without considering need and limiting the availability of the contract to the utilities' resource needs*." (Application at 13) As the Joint Parties recognize in their Application, the Decision does appropriately consider the utilities' need and expressly "*caps the total amount of QF power under the Small QF option to 110% of each utility's capacity as reflected in Table 5 of the Decision*." (Id.) This cap on the total amount of power under the Small QF Option is appropriately balanced against the need for this option.

> *[A] small QF is unable to bid in a utility RFO, generally does not have the resources or expertise required to negotiate and enter into a bilateral contract with a utility, and is prohibited by current rules from selling surplus generation directly to the CAISO*. (Decision at 121-122)

Just as critically, the Decision's Small QF Option is sanctioned by both PURPA and state law and policy. In reiterating their oft repeated refrain that the Commission's ability to grant standard offer contracts to QFs is tied to the utilities' need, the utilities once again overreach with the *Ketchikan* decision. It should not be necessary to continue repeated engagement in idle, academic exchanges regarding *Ketchikan. Ketchikan* is inapplicable. This Commission's

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[6] Defined as "QFs under 20 MW, or that offer equivalent annual energy deliveries of 131,400 MWh, and that consume at least 25% of the power internally and sell 100% of the surplus to the utilities."

Prospective QF Program, with its 110% cap for the new small QF option, is fundamentally, factually distinguishable. The Prospective QF Program explicitly balances the new standard offer contracts with avoided cost pricing for new small QFs with utilities' need by setting the 110% cap. Further, here in California:

- the Commission implements state energy policy and oversees IOU procurement;
- the Commission assesses and actually sets IOU procurement need through its approval of the cyclical procurement plans,
- the IOUs have not extinguished their procurement need;
- the Prospective QF Program furthers the established state energy policy preference for cogeneration resources.

In *Ketchikan*:

- the QF facility had not yet been constructed;
- the QF power would clearly displace energy the utility was already under contract to purchase;
- the QF sought "rights beyond what PURPA provides" (94 FERC ¶ 61,293 at 62,062); and
- Alaska does not have a statewide interconnected electric power grid like California.

Ketchikan has no relevance to California's Prospective QF Program.

Moreover, and perhaps more importantly, the must-take provisions under PURPA are not tied to a utilities' need. This is established by federal law and recognized by *Ketchikan*. 18 CFR Section 292.303 establishes the IOUs' obligation to purchase energy and capacity from QFs:

> *(a) Obligation to purchase from qualifying facilities. Each electric utility shall purchase, in accordance with Sec. 292.304, any energy and capacity which is made available from a qualifying facility:*
>
> *(1) Directly to the electric utility; or*
> *(2) Indirectly to the electric utility in accordance with paragraph (d) of this section.*

(Emphasis supplied). As the D.C. Circuit stated in *Environmental Action, Inc. v. FERC*, 939 F.2d 1057 (D.C. Cir. 1991):

> *[S]uch advantage as a QF may have stems directly from the Congress's policy choice to encourage the sale of power by QFs rather than by traditional utilities. See API, 461 U.S. at 417 ("basic purpose of §210 of PURPA was to increase the utilization of cogeneration and small power production facilities and to reduce reliance on fossil fuels"). The Commission's effort to place QFs "on an essentially equal competitive footing with competing suppliers," Opinion No. 318-A, 47 FERC at 61,740, by giving such suppliers the access it denies to QFs would effect an administrative repeal of this congressional choice; by definition, this is not in the public interest. Put otherwise, the PURPA establishes a specific public interest in encouraging QFs by giving them certain rights.*

Id. at 1062. Accordingly, the utilities' PURPA purchase obligation originates out of a Congressional desire to encourage the sale of power by QFs, not by the utility's need for power. *City of Ketchikan, 94 FERC 61,293* (March 15, 2001) is consistent with this federal law. Importantly, the Ketchikan order does not address a utility's need relative to its mandatory purchase obligation under PURPA. The Ketchikan order appropriately sets forth the existing law under PURPA and states very plainly:

> *A qualifying facility may seek to have a utility purchase <u>more</u> energy or capacity than the utility requires to meet its total system load. In such a case, <u>while the utility **is** legally obligated to purchase any energy or capacity provided by a qualifying facility</u>, the purchase rate should only include payment for energy or capacity which the utility can use to meet its total system load.*

94 FERC ¶ 61,293 at 62,062 (citing Order No. 69, FERC Statutes and Regulations, Regulations Preambles 1977-1981 ¶ 30,128 at p. 30,870)(emphasis added).

It must be stated unequivocally that the utility's purchase obligation under PURPA does not exist at the discretion of the utility. Section 210(a) of PURPA directs the FERC, in consultation with state regulatory authorities, to promulgate:

> *'such rules as it determines necessary to encourage cogeneration and small power production,' including rules requiring utilities to offer to sell electricity to, and purchase electricity from, qualifying cogeneration and small power production facilities*.

FERC v. Mississippi, 456 U.S. 742, 102 S.Ct. 2126, 72 L.Ed.2d 532 (1982) (Emphasis added). In accordance with the provisions of PURPA, the FERC promulgated regulations governing transactions between utilities and QFs. These regulations include a specific requirement that a utility must purchase electricity made available by QFs at a rate up to the utility's full avoided cost.

18 CFR Section 292.303 mandates that "*[e]ach electric utility shall purchase, in accordance with Sec. 292.304, any energy and capacity which is made available from a qualifying facility.*" (Emphasis added) Section 210(f) of PURPA requires each state regulatory authority and nonregulated utility to implement FERC's rules. 456 U.S. 742 at 751. And Section 210(h) authorizes FERC to enforce this requirement in federal court against any state authority or nonregulated utility. *Id*. For these reasons, the Joint Parties' reliance on *Ketchikan* is misplaced, and the Commission did not err in its adoption of the new small QF option.

2. The New, Small QF Option Is Consistent With State Law And Policy.

The State has played an important role in the implementation of PURPA and overseeing the contractual relationships between QF cogeneration and the utilities operating under regulations promulgated by FERC. FERC imposed utility obligations are the cornerstone of California's cogeneration policy implementation and enforcement. The establishment of standardized terms and conditions in the Commission adopted standard offer contracts is another important element underpinning successful implementation of State Policy; a State Policy that has long recognized the benefits of cogeneration that result from the encouragement of private investment in cogeneration.[7]

More recently, the State's adopted Energy Action Plan II supports the Commission's findings regarding the preservation of cogeneration resources. On August 25, 2005, the Commission approved EAP II. The CEC adopted EAP II on September 21, 2005. EAP II appropriately and expressly identifies cogeneration as a loading order resource for California. After cost-effective energy efficiency and demand response programs, EAP II provides that the State should rely upon cogeneration resources to meet demand.[8], [9]

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7 In 1978, California's Warren-Alquist Act explicitly committed the State to the promotion and development of cogeneration (§ 25004.2.). Consistent with this commitment, California Public Utilities Code Section 372 (a) states in pertinent part that: "[i]t is the policy of the state to encourage and support the development of cogeneration as an efficient, environmentally beneficial, competitive energy resource that will enhance the reliability of local generation supply, and promote local business growth." Moreover, in order to facilitate this policy, the Legislature also enacted Section 372(f) for the purpose of encouraging: … the continued development, installation, and interconnection of clean and efficient self-generation and cogeneration resources, to improve system reliability for consumers by retaining existing generation and encouraging new generation to connect to the electric grid, and to increase self-sufficiency of consumers of electricity through the deployment of self-generation and cogeneration ….

8 In furtherance of this important goal, EAP II sets forth the following key actions related to the preservation of existing CHP resources and the encouragement of new resources: (1) provide for the continued operation of existing generation needed to meet current reliability needs, including combined heat and power generation; (2) adopt a long-term policy for existing and new qualifying facility resources, including better integration of these resources into CAISO tariffs; and (3) encourage development of environmentally-sound distributed generation projects, including combined heat and power resources." (Document dated August 25, 2005, EAP II at 7)

The CEC has also recognized cogeneration as a critical loading order resource through its 2005 IEPR process. Through its 2005 IEPR, the Energy Commission recognized cogeneration as a critical loading order resource.[10] The 2005 Energy Report also recognizes the many benefits that CHP brings to the State. As the 2005 Energy Report states:

> *Cogeneration, or combined heat and power (CHP), is the most efficient and cost-effective form of DG, providing numerous benefits to California including reduced energy costs; more efficient fuel use; fewer environmental impacts; improved reliability and power quality; locations near load centers; and support of utility transmission and distribution systems.* (2005 Energy Report at 74)

The EAP II and 2005 IEPR process' recognition of cogeneration as a loading order resource is significant. EAP II describes a coordinated implementation plan for state energy policies and identifies the further actions necessary to meet California's future energy needs. The CEC developed its 2005 IEPR consistent with the EAP. With respect to cogeneration, the CEC has determined that cogeneration is an important alternative to building new central station fossil-fueled generation.

Accordingly, the Decision's new, small QF option is consistent with State law and policy and properly accounts for cogeneration's place in the California

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9 Through testimony, PG&E attempted to imply that EAP II's loading order preference for distributed generation and combined heat and power resources "may not apply" to facilities over 20 MW in size. (PG&E Rebuttal Testimony at 2-11:3-9). Upon cross examination, PG&E witness Mr. La Flash admitted that in fact neither the Commission nor the CEC ever adopted or addressed the issue of definition of the size of facility that the EAP II loading order would apply to. (Transcript 3447:7-3450:10).

10 "CHP is of such unique value in meeting loading order efficiency and new generation objectives that CHP deserves its own place in the loading order. The Energy Commission and the CPUC should therefore separate CHP from DG in the next version of the Energy Action Plan so that CHP issues and strategies are not lost in broader DG issues and strategies." (2005 Energy Report at 77)

loading order. In contrast, the Joint Parties' effort to eliminate this critical option for small QFs is contrary to State law and policy and would effectively exclude cogeneration from the loading order. Put simply, allowing the utilities to independently determine whether they "need" new, small, QFs would defeat the Commission's goals in establishing the Prospective QF Program. Allowing an independent IOU determination would also be contrary to federal and state law and policy. The Commission should reject this claim by the Joint Parties.

D. There Is No Basis In The Record To Support A Retroactive True-Up of SRAC Energy Payments.

Decision 07-09-040 addresses development of a long term policy for both existing and new QFs, and pricing for the energy and capacity provided by QFs, on a going forward basis. Pointedly, the Commission established a "*<u>Prospective</u>*" QF Program. "*[T]his decision updates the methodology for calculating SRAC energy prices on a <u>prospective basis only</u>….*" (Decision at 9) (Emphasis supplied)

The Joint Parties allege that the Decision commits legal error by failing to order a retroactive true-up of SRAC energy payments. (Application at 14). The Joint Parties allegation is without merit and should be dismissed accordingly.

First, the Joint Parties argue that the evidence in this proceeding "inescapably" supports a "*retroactive change to the MIF as of 2004*" and that "*there is no evidence in the record that would support any other result.*" (Application at 15-16) The Joint Parties make this claim without a single reference or citation to the record "evidence." There is no basis for the Joint Parties' claim. Moreover, the Joint Parties completely ignore contrary record evidence. "*[T]he SRAC Transition Formula results in SRAC energy payments that are in line with, or lower than, current avoided costs*." (Decision at 48) (Emphasis supplied)[11]

Second, the Joint Parties cite to an opinion by the Second District Court of Appeal for the proposition that the Commission has a "*legal duty to make retroactive adjustments to SRAC pricing to ensure compliance with PURPA*." (Application at 15) Specifically, the Joint Parties argue that the Court of Appeal "*expressly held that the Commission was required to determine in this very docket whether the evidence demonstrated a need for retroactive refund of SRAC energy payments*…." (Id.) The Joint Parties also discuss the Court of Appeal's determination that "*if the evidence shows that [a modified SRAC] formula … should have been applied retroactively to arrive at a more accurate SRAC, then it is the Commission's duty to apply it retroactively*." (Id.) The Commission did exactly what the Court of Appeal directed and determined that the evidence does not demonstrate a need for a retroactive refund. The Commission stated:

> *In comments, SCE has requested that the adopted MIF be applied retroactively. However, updating the SRAC formula to better reflect changes in the energy market does not, by itself, indicate that SRAC prices under the prior formula were in violation of PURPA. Furthermore, the record in this proceeding does not support a conclusion that the Modified Formula yielded prices that exceed utility avoided costs or systematically violated PURPA.*

Decision at 9.

The Commission went on to note:

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[11] And discussed in detail in Section II.B.

> *Since the outset of the QF Program, SRAC energy prices have always been set on a prospective basis. With respect to retroactive adjustments of these prices, the Commission has generally declined to make retroactive downward adjustments [footnote omitted] and we decline to do so here. Refinements to the SRAC methodology do not, in and of themselves, indicate that prior iterations of the SRAC calculations were wrong. The SRAC methodology provides an estimate of avoided cost and although we believe each refinement may increase the accuracy of the estimate, invariably whatever number is produced by the SRAC methodology will be off the mark by some, unknown amount. Constant ex ante adjustments to past payments, without any demonstration that such adjustments were necessary to comply with PURPA, create uncertainty and adds a great deal of complexity to an already complicated process.*

Decision at 23.

This is consistent with the Commission's determination in D.04-07-037 that:

> *SCE's claim that the evidence in this proceeding demonstrates that the SRAC formula violates PURPA is similarly unconvincing. According to SCE, the evidence in this proceeding shows that "the SRAC formula has yielded and will continue to yield prices for QF energy that systematically and materially exceed avoided cost." (SCE App. for Rehg. of D.03-12-062, at p. 4.) In fact, the evidence cited by SCE only demonstrates that during some periods SRAC formula costs exceeded spot market costs. This is not the same as systematically exceeding avoided costs in violation of PURPA, and the evidence in the proceeding does not show systematic and continuously excessive prices.* (D.04-07-037 at 6)

As stated by the Commission "*PURPA does not require that QF prices be less than avoided cost at all times. Rather, PURPA requires a reasonable approximation of avoided costs over time*." (Citation omitted) (Id.) The Commission's determination is also consistent with the Commission's earlier finding that "the *utilities' have not demonstrated the SRAC formula is inadequate or that it exceeds avoided costs in violation of PURPA*." (D.04-07-037 at 24) Finally, the Commission's determination is consistent with the Court of Appeal's agreement that the evidence in the judicial proceeding "*has not demonstrated* *that SRAC prices are in violation of the PURPA avoided cost standard*."[12] The Joint Parties have not presented any evidence in support of their allegation that there should be a retroactive adjustment to SRAC prices. The Commission has not committed legal error through its Prospective QF Program. The Joint Parties' request for rehearing on this issue should be rejected.

E. Extension Of The Non-Price Terms Of Existing Contracts Is Not Legal Error.

The Joint Parties argue that D.07-09-040 wrongly requires the incorporation of the new pricing adopted in the Decision into existing standard offer contracts in violation of PURPA's avoided cost standard. Specifically, the Joint Parties argue that:

> (1) the Commission's extension of existing QF contracts with modified pricing fails to reflect FERC's regulations which require the Commission to consider factors in addition to the basic commodity price avoided by the purchase from a QF in determining avoided cost; these factors would include: performance standards, dispatchability, outage terms, system emergency provisions, credit requirements and other contract terms; and
>
> (2) the extension of the "non-price" terms and conditions of existing standard offer contracts with an 80% performance requirement will yield prices that exceed avoided cost, in violation of PURPA.

The Joint Parties' first assertion that the extension of existing QF contracts fails to reflect the FERC regulations is without merit. In support of this contention the Joint Parties fail to identify any legal error. Rather, the Joint Parties merely reiterate testimony on the terms and conditions of the Amended and Restated Parallel Generation Agreement Between SCE and Kern River Cogeneration Company. The Joint Parties assert that these terms and conditions are reflective of "*more modern performance requirements*." The existing QF contracts,

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[12] See, S. Cal. Edison Co. V. Cal. P.U.C., 128 Cal.App.4th 1, 11 (2005).

however, contain non-price provisions that take into consideration the SCE cited FERC regulations implementing PURPA. These include performance standards, outage terms, and system emergency provisions.

The Joint Parties' next assertion, that existing standard offer contracts with an 80% performance requirement will yield prices above avoided cost is without merit and at odds with the facts and contrary to PURPA's avoided cost standard. The Joint Parties correctly state that "*an 80% performance requirement plainly provides less value than the new standard offer contracts with 95% and 90% performance requirements adopted by the Decision*." While the statement is correct, the Joint Parties err in its application. The Decision establishes the Resolution E-4049 Market Price Referent (MPR) combined-cycle gas turbine (CCGT) resource as the basis for the new avoided cost capacity price. Accordingly, the appropriate performance standard for a QF receiving the new pricing would be the 79% capacity factor adopted by the Commission for the MPR CCGT[13] upon which the D.07-09-040 avoided cost pricing is based. Accordingly, the 80% capacity factor standard in the existing QF contracts ***will not*** result in prices that exceed avoided cost as asserted by the Joint Parties because the appropriate standard is a 79% capacity factor.

In stark contrast to the Joint Parties' flawed assertion, the true error in the Decision is that a fundamental avoided pricing principle is violated because the adopted performance standard is not the 79% capacity factor of the MPR CCGT. Unless the new standard offer terms and conditions adjust for the excessively

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[13] Resolution E-4049 Appendix E, row 15 states that the capacity factor of the MPR CCGT is 79%.

high (in comparison with the 79% MPR capacity factor) performance standards adopted in the Decision, QFs will be paid below avoided costs in violation of PURPA.

III. CONCLUSION

For the foregoing reasons the Joint Parties' Application for Rehearing should be rejected with a single exception. That exception is the retention of Edison's existing TOU formula for determining monthly time differentiated SRAC energy pricing and the existing TOU factors underlying that formula.

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November 9, 2007

CERTIFICATE OF SERVICE

I, Karen Terranova hereby certify that I have on this date caused the attached **Response of the Cogeneration Association of California and the Energy Producers and Users Coalition to the Joint Parties' Application for Rehearing of D. 07-09-040** in R04-04-003/R04-04-025 to be served to all known parties by either United States mail or electronic mail, to each party named in the official attached service list obtained from the Commission's website, attached hereto, and pursuant to the Commission's Rules of Practice and Procedure.

Dated November 9, 2007 at San Francisco, California.

Karen Terranova

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